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No. 170

IN THE

Supreme Court of the United States

OCTOBER TERM 1955

GENERAL STORES CORPORATION, PETITIONER

vs.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS' COMMITTEE and WAGE CLAIMANTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITIONER'S REPLY BRIEF

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Corrections to Statement of the Case

1.

The Securities and Exchange Commission has depreciated the extent of the interest of the wage claimants in the present proceeding where they claim that their priority, secure in Chapter XI, will be lost by dismissal of these proceedings or transference to Chapter X. (See SEC brief n 23, page 41.)

The Referee, we are informed, has received wage claims aggregating $267,287.04 of which $90,807.60 has been assigned priority within the limit of $600 per claimant. (See also Wage Claimants' brief, p. 2.)

2.

The brief for the Securities and Exchange Commission characterizes petitioner's financial condition as "shaky" and in several places, as existing "for many years". (Brief, p. 3 says it relates "back at least to 1936"; see also p. 20.) Obviously, no debtor being in "sound financial condition" in the usual sense of paying its bills and preserving its capital would ever need to resort to any of the chapters of the Bankruptcy Act. It must be assumed, therefore, that the said respondents are not referring merely to the condition which gave rise to the present proceedings, but are implying something a great deal more.

In all fairness, therefore, it must be emphasized that, following a successful reorganization of petitioner in 1940, it is undisputed that petitioner had very profitable years during the war and thereafter. Since that time its financial difficulties have been economic, patent to all, including the SEC, and fully disclosed to its stockholders.

It must also be conceded that there is no evidence that petitioner has not been wise and correct in liquidating the unprofitable operation and buying up the profitable Ford-Hopkins and Stineway chains. By an aggregate purchase for $4,020,320.50 (Record 48a and 71a), debtor acquired net earnings before depreciation and taxes which for three years previous amounted to an average per year

of $679,000. (Record 41a). Since both these acquisitions were reported to stockholders through proxy statements cleared with the Securities and Exchange Commission, at a time when the petitioner's stock was registered with the SEC, any unfavorable implications with regard to such operations come very tardily from the Commission.

There is nothing whatsoever in the record which would support any implication but that the decision of management taken in 1953 and 1954 was sound and in the best interests of stockholders. The investing public is not affected. This was pointed out below by Judge Galston, 222 F. 2d at 238. He added the point that there was nothing here which required reorganizing.

Reply Argument

(a) Comparison Between the Adequacy of Chapter X and Chapter XI Can Be Made Upon the Basis of the Specific Plans.

The Commission's brief, at pages 10 and 26, presents the fallacious argument that since under Chapter X no "plan" is required at the outset of the proceedings, the comparative adequacy of the relief afforded in X with that afforded in Chapter XI cannot be made at the outset of the proceedings. The Commission's argument totally overlooks the initial statutory requirement in every Chapter X proceeding that the petition "shall state the specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under Chapter XI of this act." (Section 130(7) of the Bankruptcy Act.)

Obviously, it is incumbent upon the petitioner in Chapter X to state specific facts showing that petitioner requires relief beyond mere composition or arrangement with its unsecured creditors. Unless the facts shown exclude the possibility of relief obtainable by a debtor's petition under Chapter XI, the petition in Chapter X is, as a matter of law, filed in bad faith. (Section 146(2).)

In short, every petition in Chapter X which complies with the requirement of Section 130(7) and every petition in Chapter XI which complies with Section 323 to the extent of setting forth "the provisions of the arrangement proposed by him" affords the court ample facts for a comparison of the adequacy of relief afforded in that specific case under either chapter. On the one hand, the court can determine whether the petition in Chapter X has been improperly filed there because adequate relief can be obtained by the debtor's petition under Chapter XI. (See Section 147.) On the other hand, the court can determine whether the debtor's petition filed in Chapter XI is improperly filed there because adequate relief may not be obtained by the debtor's petition in that chapter and that debtor may have recourse under Chapter X. (See Section 328.)

The parallel structure and purpose of Sections 147 and 328 cannot be denied, since the avowed purpose of Congress in 1952 was to supply Section 328 in view of the lack of this provision corresponding to Section 147 of Chapter X. (See House Report quoted in our brief as Note to page 15.)

(b) It Was the Plan Which Was Decisive of the *U. S. Realty* Decision.

The Commission's brief, at page 25, fallaciously insists that the character of the debtor, rather than the plan proposed, was determinative of the *U. S. Realty* decision. (Compare the admission in Shlensky Brief, p. 9, and Judge Clark in the *Mecca Temple* case, 142 F. 2d at 872.) An analysis of the whole opinion of Mr. Justice Stone must demonstrate that the portion of the opinion quoted and referred to in our brief, page 11, based upon the failure of the plan on its face as contained in the petition to meet the fair and equitable test, was the determinative factor. We shall argue here only the matters of correlative legislative history upon which the Commission's brief relies.

In the first place, the Commission's brief argues, pages 34 and 35, that the withdrawal in Congress at the time of the *U. S. Realty* decision of a proposed amendment to Chapter XI to exclude from that chapter a corporation with 100 or more security holders in any one class constituted legislative interpretation of Mr. Justice Stone's opinion that the Bankruptcy Act needed no such amendment. To the contrary, Mr. Justice Stone's opinion pointed out that the Act does not define what is a large corporation. (310 U. S. at 447.) The deficiency in the Act was what Judge Frank hoped to supply by the court decision below (222 F. 2d 237.)*

Indeed, it ought to be conceded that the controversial question raised during the formative stages of the Chand-

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* See also Judge Clark's admission in the *Mecca Temple* case, 142 F. 2d 869 at 871, that "there is still no well-defined answer."

ler Act and referred to by Mr. Justice Roberts (see our brief, page 41) was still controversial during the period that the *U. S. Realty* case was in the courts (Commission's brief, page 34) and was not set at rest by the *U. S. Realty* case. (See the *Transvision case*, 217 F. 2d at 246, and Judge Frank's opinion below, 222 F. 2d 237 and *Mecca Temple* case, 142 F. 2d at 871.)

It is particularly important to note that this controversial question was not settled or even raised in the 1952 amendments to the Bankruptcy Act. As the Commission's brief is at pains to emphasize, there was nothing controversal about the 1952 amendment. (SEC brief, pp. 11 and 32.). On the one hand, it supplied in Chapter XI the lack of a provision corresponding to Section 147 of Chapter X. On the other hand, it re-enacted the rule that the primary standard of a composition or plan of arrangement was that it should be satisfactory to creditors rather than comply with any "fair and equitable" rule imported from equity receiverships or old Section 77B.

Certainly the "hot potato" as to whether the "character" of the debtor could exclude it from the benefits of Chapter XI was scrupulously avoided by Congress in enacting the 1952 amendments. If Congress was under the impression that the observations by Mr. Justice Stone on this subject in the *U. S. Realty* case constituted the basis of the decision of this court, and if Congress had any intention to "codify" such observations, it is perfectly obvious that the Commission's contentions in this case would have received Congressional enactment through the 1952 amendments.

Congress has never recognized the SEC's extreme contention in this and the *Transvision* cases. The interest

of general unsecured creditors, rather than common stockholders, continues to be the primary interest of the bankruptcy courts. Alteration of this point of view would require clear Congressional action.

In order that our position before this Court with respect to the important *U. S. Realty* case may be clearly understood, we point out:

(1) Because we believe that the basis of the *U. S. Realty* decision was the fact that under the law then in force, the plan could never obtain confirmation in Chapter XI, we think that case was correctly decided on the procedural point that the Court, faced with the inevitability that the Court was without power to confirm the plan, had a duty and power to shorten the abortive proceeding. Congress confirmed the power by the 1952 amendment.

(2) Because we believe that "fair and equitable" was imported by the original Chandler Act into Chapter XI where no corresponding phrase had appeared in the predecessor Section 12 for compositions, we think the *U. S. Realty* case was correctly decided in holding that such words in Chapter XI have the same meaning as given them in Chapter X and its predecessor Section 77B. That Congress by the 1952 amendments deleted the words and permitted proceedings in Chapter XI to be administered on the same standards for confirmation of a plan as that which had existed in its predecessor Chapter 12, confirms us in our opinion.

(3) Because we believe that Congress has since the formative stages of the Chandler Act been well aware of the contentions of the Securities and Exchange Commis-

sion that large corporations with public stockholders should be excluded from the benefits of Chapter XI, regardless of the plan or relief sought, we think that to the extent that Mr. Justice Stone implied concurrence with the contentions of the Commission, his observations were both unnecessary to the decision and incorrect. The failure of Congress to enact or codify the contentions of the SEC in this regard confirms us in our opinion.

(4) To the extent that in a Chapter XI proceeding the debtor proposes to modify the rights contained in publicly distributed debt securities, as was the exact case in *U. S. Realty*, we believe the Court might be faced with the necessity of deciding a conflict between the public policy, as expressed in the Securities Act of 1933 and the public policy as expressed in Section 146(2) of the Bankruptcy Act. To the extent, therefore, that the *U. S. Realty* plan sought to modify the publicly-held debt security, we think that Mr. Justice Stone's preoccupation with the public interest, in that case to be protected by the SEC, may well have been correct.* However, Congress has not even codified this aspect of the *U. S. Realty* case. The issue does not exist at all in the *General Stores* case because only trade and commercial debts are intended to be affected.

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* The SEC brief, page 33, misunderstands our position in this regard. We neither urge that the *Realty* decision be swept aside, nor admit that reversal in this *General Stores* case would mean that a debtor with publicly-held debentures could deprive such holders of their right to absolute priority in a proceeding under Chapter XI. For that reason the Shlensky brief, page 11, is in error for implying that we believe that absent the "fair and equitable" rule, the *Realty* decision might not have come to the same conclusion because publicly-held debt securities were planned to be adversely affected.

CONCLUSION

The *U. S. Realty* case is not controlling of this case, not because the *U. S. Realty* case was incorrectly decided or because Congress changed the law with express reference to that decision, but rather, because the Court was not faced in the *U. S. Realty* case with the issue raised in this case.

In this case there are no publicly distributed and held debt securities and the only persons affected by the proposed plan are unsecured trade and commercial creditors. The Court may not, in the absence of any allegations or proof that irreparable harm might be expected from a continuance of these proceedings, simply dismiss the proceedings because the debtor is a large corporation having public stockholders.

Certainly that was not the question which faced this Court in the *U. S. Realty* case. In accepting the argument that the *U. S. Realty* decision is controlling in the present case, the courts below were in error and the decisions should be reversed.

Respectfully submitted,

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